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Inspire Performance™

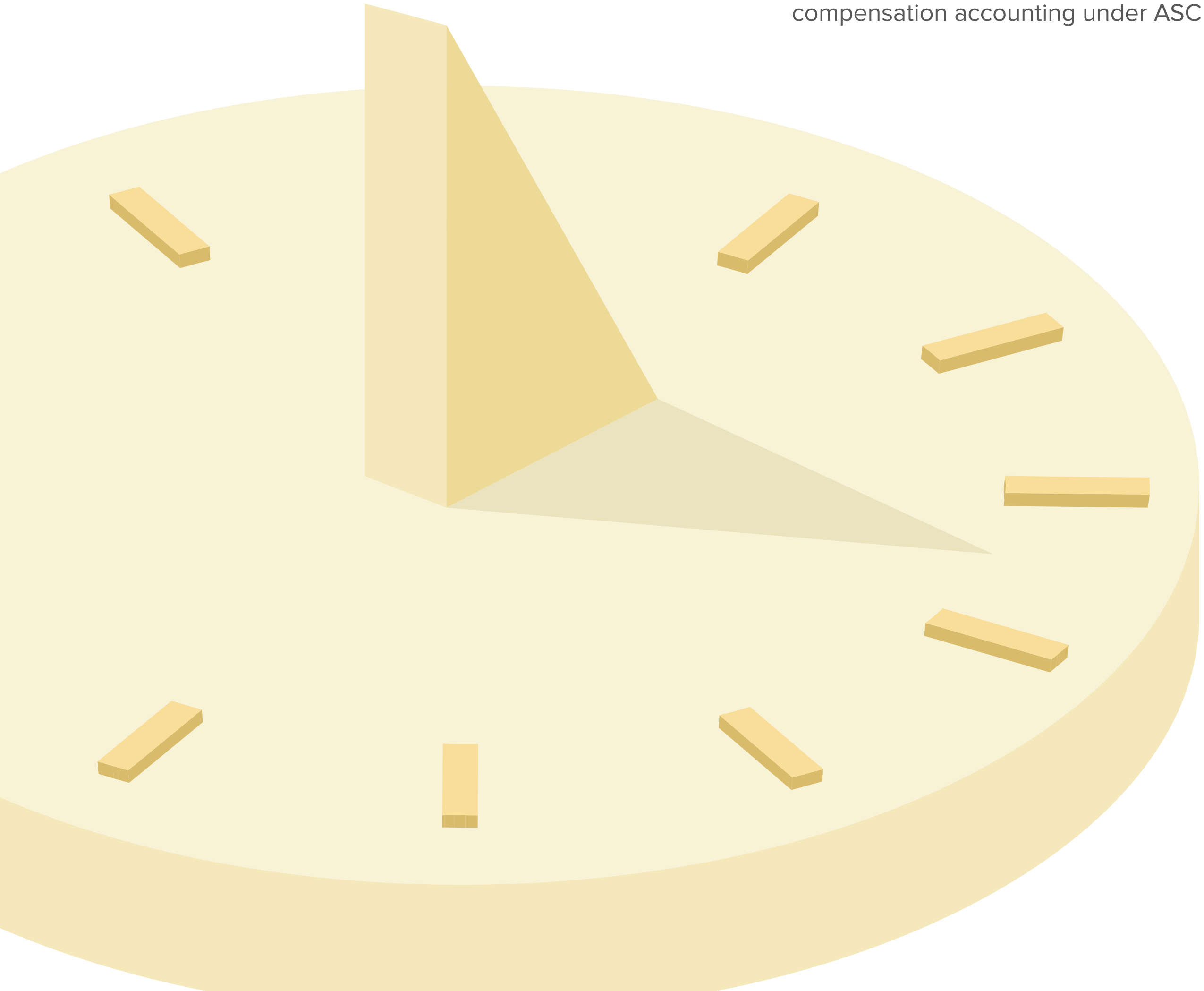
SURVIVING ASC 606

A how-to guide to get your team ready to manage the new complexity associated with commission accounting!

ASC 606 IS HERE.

The accounting standards changed for public companies with the implementation of ASC 606 (and will change for private companies in December 2018) from being industry-specific and rules-based to industry-agnostic and principles based. Most ERP vendors and major accounting firms agree that the new standards represent the largest accounting standard change in over a decade.

The changes to the Revenue Recognition Standards impact more than just how revenue is recognized, but also how expenses such as amortizing sales commissions are recorded, and there are several misconceptions about compensation accounting under ASC 606.



MYTH: ERP SYSTEMS CAN ADDRESS THE REQUIREMENTS

REALITY

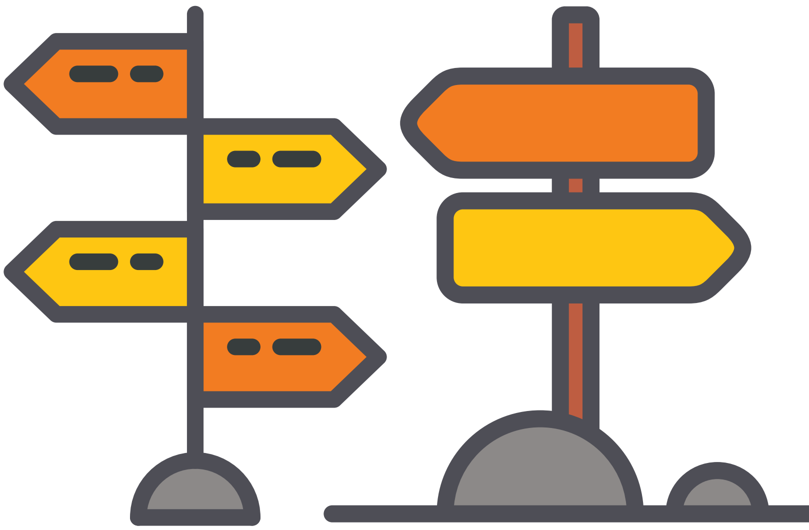
ERP systems are generally not designed to track the details of sales compensation. Subscriptions are prone to change which will most likely result in changes to commissions, so it isn't realistic to solely use your existing ERP to manage capitalization costs.

MYTH: CURRENT PROCESSES CAN HANDLE THE INCREASE IN DATA

REALITY

Today, approximately 72% of organizations are still using spreadsheets to manage their commission process. Under the new requirements, you will need to generate detailed waterfall tables, and this new level of detail is going to make your data EXPLODE! We typically see data explosion 20 to 100 times for a standard implementation, and for most companies, spreadsheets haven't been able to keep up.

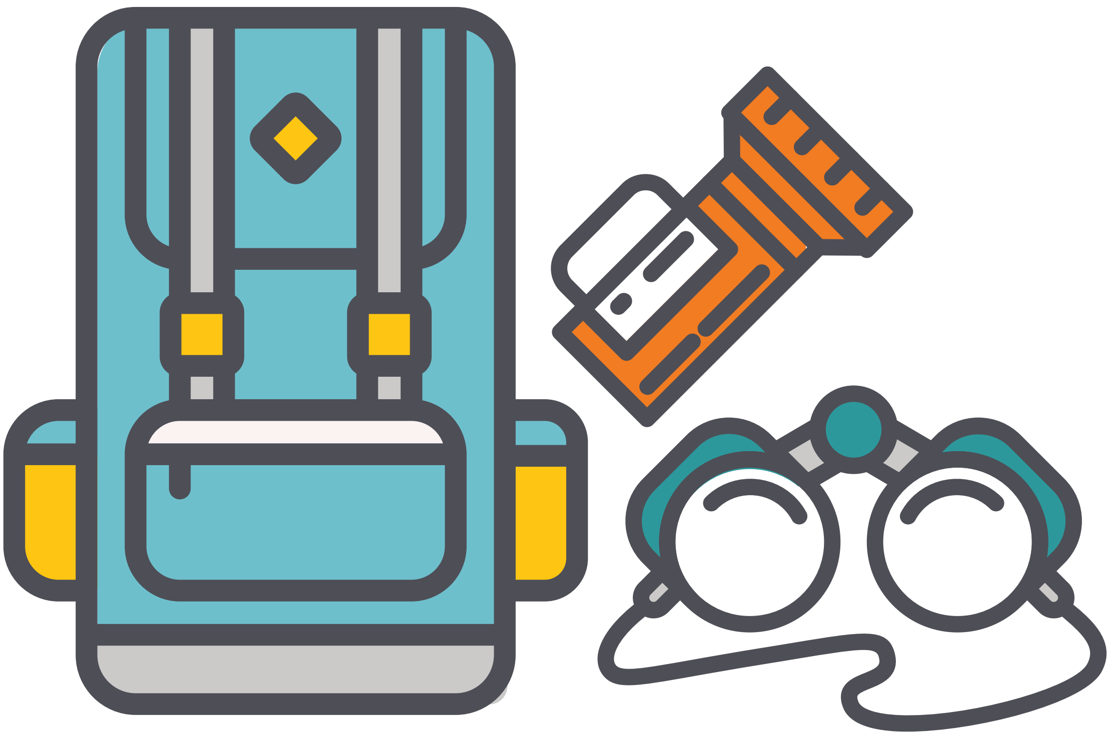
MYTH: CHANGES CAN BE EASILY MANAGED



REALITY

The subscription economy is defined by change and as your company grows, there will definitely be change. For every change in a subscription business (dates, levels, payment terms, number of users, etc.) amortization has to be changed accordingly, which is followed by a waterfall of complex calculations.

PREPARATION IS KEY TO SURVIVAL



Just like surviving in the wilderness, you need to know your surroundings and be prepared to ensure that you're ready for anything that comes your way. Although you're not looking for shelter and water supplies, you need to have a full understanding of the systems that you use to run your accounting processes and understand how you can to utilize them for ASC 606 compliance.

In addition, the nature of a subscription business is defined by change. Every change, while exciting for a company's growth, means additional accounting and processes, especially with updates to accounting standards. Typically, one of the biggest expenses associated with obtaining contracts with customers is incentive compensation, and for subscription businesses, that typically includes more than just the sales teams' commission.

Compensation also includes professional services, customer success, account management, general management, and everyone else whose objectives and variable compensation is directly associated with obtaining and executing the contract. Any time there is a change to a contract (subscription line items added, numbers of users amended, etc.) the amortization must reflect that change, which is followed by a waterfall of complex calculations.

FOLLOW THE RULES

To be compliant with ASC 606, organizations must first decide whether they are going to take the full or modified retrospective approach and if they will amortize at the portfolio or contract level. It's important to weigh the pros and cons of each approach to find the right solution for your company.

Full Retrospective Approach

Under the full retrospective approach, two years of historical financial statements need to be restated. This approach is practical for companies with access to their contract and commission details at a granular enough level to support the restatement process.

Modified Retrospective Approach

If they choose the modified retrospective approach, their financial statements must be reported under the old and new standards during the adoption year with an adjustment being made to the retained earnings balance under the new standard. This approach limits the amount of year over year trend analysis that can be conducted.

Next up, amortization.

Portfolio-Level Amortization

The portfolio approach bundles like-contracts together, aggregates the associated commissions, and then amortizes the earnings. Naturally, there is less data in this approach. This is good for traditional-based business models, and those with very little change whose customer contracts are all very similar.

Contract-Level Amortization

Most subscription-based businesses are moving towards the contract-level approach. Things move so quickly in these organizations that an audit trail is needed to help track all of the changes. Amounts paid out for commissions must reconcile with what's been capitalized and amortized over time, making it an ongoing process for these ever-changing businesses. This method is more complex, but it gives greater visibility of the overall compensation accounting process.

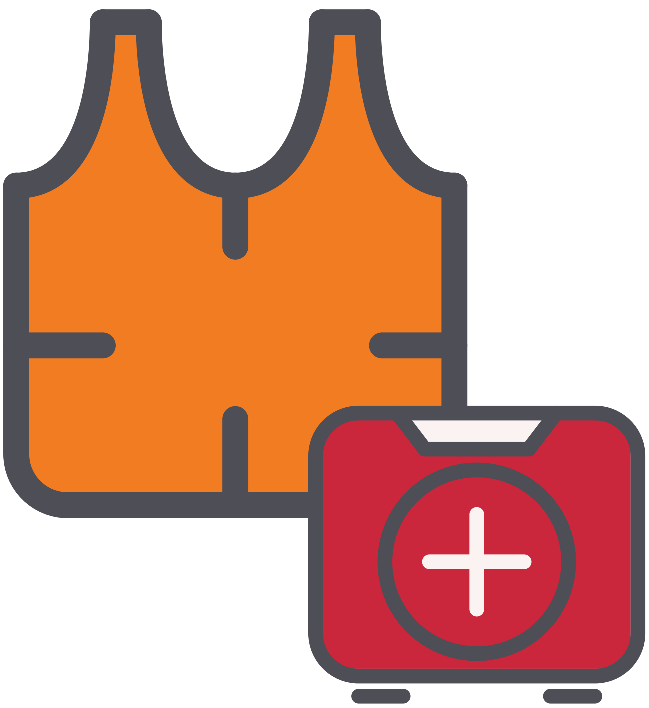
BE ADAPTABLE

From a commission accounting perspective, the new standards are going to require collaboration across multiple departments, including sales, sales ops and compensation, and finance. The structure of a company's compensation plans will also affect the complexity of the related accounting, especially in cases where multiple sales reps receive compensation for a single transaction.

However, your compensation plan designs won't necessarily need to change, but companies will need to be more aware of the impact of plan designs on downstream accounting and the potential administrative workloads that could be introduced.

Companies with a moderately large set of commissioned employees and complex sales compensation plans will most likely find that sales performance management (SPM) software can give the sales management team flexibility in building, testing, and monitoring compensation plans. To properly account for the capitalization and amortization balances, as well as the changes to those balances, you're going to encounter roughly 100 times the commission data that is managed today.

THE ONLY SPM SOLUTION FOR COMMISSION ACCOUNTING UNDER ASC 606



A Sales Performance Management solution will give the sales team greater flexibility in setting and modifying compensation plans. The software will allow sales reps to spend less time checking their compensation calculations and will ensure that they aren't under or overpaid. For finance teams, the software can also simplify the accounting, forecasting and analysis of sales compensation.

More specifically, here's how Xactly CEA can help:

- Seamless integration with your core applications (ERP/ RBM/CRM) to capture all revenue events in an accurate and automated manner
- Calculation of 100% of your compensation expenses directly tied to the customer contracts/invoices
- Automate the maintenance of your commission capitalization and amortization balances; according to ASC 605 and ASC 606.
- Dynamically adjust/change amortization schedules and rules based on contract, account, payee and/ or plan changes.
- Incorporate accrual accounting into the end to end process.

To learn more about commission accounting under ASC 606, visit

https://www.xactlycorp.com/commission-expense-accounting/

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xactlycorp.com   1-866-GO-XACTLY

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Xactly Corporation, 300 Park Avenue, Suite 1700, San Jose, CA 95110